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SUBJECT: HMG ACCUSED OF SEEING NO BLAME, HEARING NO BLAME, AND TAKING NO BLAME FOR FINANCIAL CRISIS

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¶1. (SBU) Summary: The Treasury Select Committee held an unprecedented evidence session November 3 in which the Tripartite Committee authorities responded to Parliamentary questions and to questions emailed to the Committee by the general public. In their responses, the Chancellor of the Exchequer Alistair Darling and Lord Turner, Chairman of the Financial Services Authority (FSA), accepted some responsibility for the financial crisis but said there are several levels of blame. They acknowledged there are lessons to be learned, particularly regarding greater cooperation between regulators on an international level. Mervyn King, Governor of the Bank of England, added that work needed to be done on capital requirements and the regulation of liquidity. Lord Turner was keen to emphasize that the FSA has already started internal reform. End Summary.

"I accept responsibility" - Within Limits

¶2. (SBU) In an unprecedeted evidence session held by the House of Commons Treasury Select Committee, the Tripartite Committee authorities appeared together to give evidence November 3. Chancellor Alistair Darling, Bank of England Governor Mervyn King, and Lord Adair Turner, the new Chairman of the FSA, answered questions emailed to the Committee by the public. More than 5,000 emails were received on a range of issues including the banking bail-out, the housing market, the international regulatory structure, and compensation schemes.

¶3. (SBU) Michael Fallon, the Conservative Deputy Chairman of the Committee, said that many emails concerned the question of responsibility and said there was an impression of "see no blame, hear no blame and take no blame." Chancellor Darling said "I accept responsibility for everything I'm responsible for" but added that there were several levels of responsibility. The national regulators needed to take some of the blame; there needed to be a stronger international framework, and the boards of banks needed to take responsibility as the first line of defense of their own institutions. Lord Turner said that responsibility was shared on a global level as there was a global failure to see enormous risks developing in the financial system.

Lessons to be learned

¶4. (SBU) While individual regulators focus on events within their own areas of responsibility, the financial system was deficient in spotting problems that were building up across several countries, stated the Chancellor. The UK, therefore, will argue for greater cooperation between regulators. He said it was important to have greater surveillance and far better monitoring of the problems that are building. As the world became smaller, the Chancellor added, it was more important than ever that regulators maintained a global

view.

15. (SBU) There were three areas where work needed to be done, according to Mervyn King. First was on the level of capital requirements. He said this was being looked at by the Financial Stability Forum. He said the immediate need was not to force banks to have higher capital requirements but to have more capital. Second was on the regulation of liquidity and the amount of capital that needed to be put aside. King said the UK was taking a strong lead in the Basel fora to bring the discussion back to the regulation of liquidity. Finally, on counter-cyclical capital requirements, he said this needed to be worked on in an international forum and would take time.

16. (SBU) Compensation structures were mentioned in a large number of the emails submitted to the Committee. Lord Turner said that the FSA has the ability to tell firms that their bonus structures were inappropriate and also had the ability to reflect inappropriate bonuses in a higher level of capital requirement. He said they would consider these options during international regulatory discussions. The Chancellor added that we should avoid a situation where institutions have bonus structures that drive people into taking extreme risks. One Committee member suggested that when the FSA did its assessments on firms, it should take into account the bonus payments and incentives of the firm.

17. (SBU) Sally Keeble, a Labour member of the Committee, questioned the Chancellor about credit rating agencies. Darling said that any regulation would need to be on an international level to avoid regulatory arbitrage. He said that at the last meeting of the European Finance Ministers in September, they made substantial progress and he was optimistic that something can be agreed by the end of 2008 or early 2009 (on a Europe-wide level). The regulation is likely to be stronger than voluntary regulation. The Chancellor added that CRAs will be discussed at the G20 meeting later this

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month.

Action taken by the FSA

18. (SBU) Since the FSA's mea culpa in March, which admitted that there were inadequate resources devoted to high impact firms, too rapid turnover of key staff, and a failure to document and stick to procedures, the FSA has instituted a 'Supervisory Enhancement Programme.' Lord Turner said this entailed the hiring of 218 additional people focused on relationship management. Of these positions, 38 percent have been filled. The FSA anticipates the completion of this program by spring 2009. In addition to recruiting more staff, the FSA is focused on the quality of people employed. It has designed a new induction program for all new supervisors, consisting of a nine-week course in core supervisory skills.

TUTTLE